WALL STREET JOURNAL.

WEDNESDAY, MAY 11, 1983

Let's Talk Money at Williamsburg

By LEWIS E. LEHRMAN

Williamsburg is an economic summit without an agenda. That shouldn't be surprising, for the West today has no coherent economic order—unless you count austerity and sacrifice.

Recently, I returned from a trip to European capitals. Central-bank officials and ministers of trade did acknowledge the profound problems of monetary disorder, exchange-rate fluctuations and their protectionist effects. Yet, while the French government now calls for a return to the Bretton Woods system—profoundly flawed itself but certainly more effective than the present float—no minister with whom I spoke believed international monetary problems would be formally discussed at Williamsburg. This pessimism about the possibilities of reform is striking, coming only six months after Treasury Secretary Regan called for a monetary conference.

The issue of international monetary reform and the new arguments for different systems of fixed exchange rates arise from the failures of the managed currency float of the past 10 years. During this period, economies of the West declined and protectionism intensified. Ideas of reform originated in the 1960s, with the purpose of curing the primary defect of Bretton Woods—the reserve currency status of the dollar, which led to a permanent balance-of-payments deficit in the U.S. These ideas have not yet been sufficiently considered. Now is the time to do so.

The evidence is compelling that reconsideration of the world monetary system is overdue. One need only review the history of the last few years in America, Britain, Germany and France, as their economies declined under the weight of the monetary and interest rate disorders engendered by central bank money market manipulation.

In Britain in 1979, Margaret Thatcher's Conservatives campaigned against the Keynesian credit policy of the Bank of England and the sterling depreciations of the Labor government. Mrs. Thatcher's campaign called for a stable currency, economic growth, low interest rates and financial order. After nearly four years of austerity and an unapologetically monetarist central banking policy, Britain still has 13% unemployment. Output is no higher than four years ago. Meanwhile, the pound's value fell from $2.50 to $1.45—beneath the lowest level under the Labor. The cost of credit, the touchstone of economic growth, hovers at real rates of 8% to 10%, depending on the quality of the borrower, even as the public-sector borrowing requirement has diminished as a percentage of GNP.

France's Currency Collapsed

In France, Francois Mitterrand's Socialists campaigned in 1981 against the credit and budget austerity of President Giscard. They promised a statist industrial program of economic expansion. However, Mr. Mitterrand's conventional neo-Keynesian policies of government spending and credit expansion led to the collapse of France's currency. The trade deficit grew to $14 billion a year and domestic inflation intensified. Now, the new Mitterrand policy of austerity, designed to deal with the crisis is, of all things, Thatcherite monetary targeting joined to the most draconian inequity of all—wage and price controls aimed at lowering real wages. Despite the stringency of the Mitterrand austerity, interest rates have risen and unemployment is over 9%. He has repudiated the very goals of economic expansion and job growth for which his government was elected.

In Germany in 1982, Helmut Schmidt's Social Democrats also presided over rapidly rising unemployment occasioned by the government-sponsored Bundesbank policy of credit austerity, monetary targeting and high interest rates. By the summer of 1982, Mr. Schmidt's coalition fell apart as his Free Democrat allies, sensing repudiation, switched affiliation to the Christian Democrats. What made Hans Dietrich Genscher and his Free Democrats jump ship was massive defections from the Schmidt economic policy, as measured by opinion polls. Germans of both parties rejected the policies of austerity.

Capitalizing on discontent with austerity, Helmut Kohl's CDU negotiated a deal with the FDP and shrewdly called for early elections in March 1983. They won those elections by a decisive margin, campaigning for a program of economic recovery.

In the U.S., President Reagan came to office in 1980 after a brilliantly successful campaign based on job creation, new investment, stable money, lower interest rates and economic growth. It is true that inflation has come down. And it is true that, unlike most of his Western European counterparts, Mr. Reagan has significantly reduced marginal tax rates. But the real cost of credit for homes and business is still unacceptably high. Industrial production does not yet exceed 1979 levels. There are still over 11 million unemployed.

Only a world currency will work. That is why having national currencies convertible to gold—an international money—has worked in the past and will work again.

The credit policy of Fed Chairman Paul Volcker has brought down inflation while producing one of our greatest recessions, a world banking crisis, and a political setback for the Republicans in November 1982. But the policy of monetary austerity, and the recession it caused, was not President Reagan's program of 1980. It was instead the policy of the Fed and the Office of Management and Budget. Like Mrs. Thatcher, Mr. Reagan unwittingly fell into the trap of his advisers who advocated credit austerity.

And so the West sways between expansionist central bank credit policies that lead to the euphoria of inflation, and austerity policies of credit contraction, which lead to the despair of unemployment and spiritual poverty. In a larger sense, and to some practical extent, this stop-go economics has impoverished us all. European and American workers are punished by Socialists and Conservatives for the "sin" of wanting wages that keep up with inflation.

In the meantime, because of unemployment, Western governments are preoccupied with the balance of trade—an all-time fallacy. The specter of protectionism is on the rise. But our disorders in the world trading system cannot be cured by GATT or by trade agreements. Those disorders are monetary in origin. Protectionism thrives on competitive exchange-rate policies, brought about by the abrupt currency depreciation and appreciations of well-meaning but uncertain central bankers and politicians.

Many central bank officials in Europe speak with pride about the new austerity. They look with equanimity on the 35 million unemployed of the OECD countries. The question is: Must policy makers put 2.5 million people out of work in Germany, 3 million in Britain, 11 million in the U.S.—in order to reduce inflation? Surely those who still believe in the future of the Free World and in the American dream must answer: No, there is a better way. Only national and international monetary reform can cure our monetary disorders.

It was the German monetary reform of 1948, based on a new convertible currency—a deutschemark tied to gold—that along with deregulation produced the German Miracle. It was the creation in 1959 of a convertible gold franc, which brought forth the savings and investment, that made the Fifth Republic of De Gaulle rich enough to create both nuclear defense and national prosperity. The gold convertibility of the dollar, and multilateral convertibility in Europe—the hallmarks of the Bretton Woods system—created the conditions for postwar prosperity. But the Bretton Woods system had the great flaw of being based on the *official* reserve currency status of the dollar.

System Is in Deep Trouble

The monetary order of Bretton Woods was never reformed in this respect. As a result, when the dollar collapsed in 1971, Bretton Woods collapsed too, just as Prof. Jacques Rueff and Robert Triffin forecast in 1959.

There is no major country yet willing to look at the fundamental flaw of the international economic system: the notion of political leaders that national economic and monetary policy can be made independent of the world economy.

The truth is that there is only one economy. It is the integrated world economy. Therefore, national economies need a monetary coordinating mechanism. And that is why an integrated world economy needs a common monetary standard, which is the best neutral international coordinating device. But no national currency will do; only a world currency will work. That is why having national currencies convertible to gold—an international money—has worked in the past and will work again.

Even Mrs. Thatcher was recently quoted as saying, "It's absolutely vital for us to jointly pursue policies which enable us to get and keep interest rates down and to keep inflation down." There *is* such a policy. The policy of convertible currencies, linked to an international monetary standard, is the only one which has worked reasonably well in the past. The policy is imperfect, as are all human institutions; but a system of fixed exchange rates which is the incidental by product of the real international gold standard is the least imperfect of the international monetary systems we know. Without such a free-world monetary order we shall never restore sustained price stability, long-term capital markets at low interest rates, and the investment boom which alone can lead to reasonably full employment.

Without a reformed monetary system of multilateral, unrestricted convertibility of the major Western currencies into gold, we shall continue in a topsy-turvy world, oscillating between autarky and entropy. Incredibly, Socialists will talk of reducing the real wages of workers to increase profits and end trade imbalances, as they do now in France. And self-styled anti-Keynesian Conservatives will rely on neo-Keynesian central bank credit expansion to create economic booms in order to end austerity and get reelected.

The international monetary system is in deep trouble; we won't just muddle along much longer. The time to deal with the so-called "structural" problems of our monetary order is now. If we do, we can once again create conditions of rapid non-inflationary growth. If we don't make the reforms, sooner or later the world economy will founder.

Only the U.S. can take the lead. We must begin at Williamsburg.

Mr. Lehrman, who ran for governor of New York in 1982, is writing a book on economics and monetary policy.